

**STATE OF CONNECTICUT CLEAN WATER FUND -
WATER POLLUTION CONTROL AUTHORITY FEDERAL
REVOLVING LOAN ACCOUNT (STATE REVOLVING FUND)**

**AUDIT REPORTS AND SCHEDULES IN
ACCORDANCE WITH OMB CIRCULAR A-133**

JUNE 30, 2005 AND 2004

**STATE OF CONNECTICUT CLEAN WATER FUND –
WATER POLLUTION CONTROL AUTHORITY FEDERAL
REVOLVING LOAN ACCOUNT (STATE REVOLVING FUND)
JUNE 30, 2005 and 2004**

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SEWARD AND MONDE

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INDEPENDENT AUDITORS' REPORT

Ms. Denise L. Nappier, Treasurer

Ms. Gina McCarthy, Commissioner,
Department of Environmental Protection,
State of Connecticut

We have audited the accompanying financial statements of the State of Connecticut Clean Water Fund – Water Pollution Control Authority Federal Revolving Loan Account (State Revolving Fund) (SRF) (an enterprise fund of the State of Connecticut) as of and for the years ended June 30, 2005 and 2004, as listed in the table of contents. These financial statements are the responsibility of the SRF's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Clean Water Fund - Water Pollution Control Authority Federal Revolving Loan Account and do not purport to, and do not, present fairly the financial statements of the State of Connecticut, as of June 30, 2005 and 2004, and the changes in its financial position and cash flows, where applicable, for the years then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State of Connecticut Clean Water Fund – Water Pollution Control Authority Federal Revolving Loan Account - SRF as of June 30, 2005 and 2004, and the changes in financial position and cash flows thereof for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 26, 2005 on our consideration of the State of Connecticut Clean Water Fund – Water Pollution Control Authority Federal Revolving Loan Account – SRF’s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in conjunction with this report in considering the results of our audit.

The management’s discussion and analysis on pages 3 through 7, is not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Seward and Monde

North Haven, Connecticut
August 26, 2005

**STATE OF CONNECTICUT
OFFICE OF THE TREASURER
STATE OF CONNECTICUT
CLEAN WATER FUND
FISCAL YEAR ENDED JUNE 30, 2005**

MANAGEMENT'S DISCUSSION AND ANALYSIS

This is a narrative overview and analysis of the activities of the State of Connecticut Clean Water Fund for the fiscal year ended June 30, 2005. Readers are encouraged to review it in conjunction with the Fund's financial statements that follow.

The Clean Water Fund has implemented Governmental Accounting Standards Board (GASB) Statement No. 40 as required during the fiscal year ending June 30, 2005.

Financial Highlights

Changes in Net Assets – Fund net assets under management in the Clean Water Fund at the close of the fiscal year 2005 were \$531,043,094 (including assets of \$1,080,578,075 offset by liabilities of \$549,534,981) compared to fiscal year 2004 Fund net assets of \$505,954,383 (including assets of \$1,096,521,391 offset by liabilities of \$590,567,008). Fund net assets increased by \$25,088,711 or 4.96% primarily reflecting lower debt outstanding. The Statement also shows restricted fund net assets of \$478,813,168 at the close of fiscal year 2005, an increase of \$29,758,509 or 6.63% above the 2004 balance.

Operating Revenues – The Fund's gross operating income remained relatively constant decreasing slightly by \$24,908 to \$12,242,727.

Statement of Cash Flows – The Statement of Cash Flows shows an increase in cash for the year of \$1,393,509.

Bonds Outstanding – No new bonds were issued during the year. The Fund's total debt outstanding decreased during the fiscal year by \$38,207,170 to \$521,968,430 due to scheduled amortization.

Loans Receivable – Total loans receivable decreased by \$31,624 from \$616,045,485 to \$616,013,861 due to the net of new loans and repayments.

Capitalization Grants - There were no new Federal wastewater capitalization grants awarded in fiscal year 2005. During the year, \$15,136,554 was drawn from the EPA for projects, compared to \$1,713,604 drawn in 2004. The State has drawn all but \$19,729,774 of the \$327,222,396 in cumulative federal wastewater capitalization grant awards.

Overview of the Financial Statements

The Clean Water Fund financial statements are reported by the Office of the Treasurer in conjunction with the Department of Environmental Protection (DEP). The Treasurer is responsible for the detailed financial information in the Clean Water Fund financial statements.

The Clean Water Fund is classified as an enterprise fund within the Proprietary Funds of the State of Connecticut. Proprietary Funds focus on the determination of the change in fund net assets, financial position, and cash flows for governmental activities that operate similar to a commercial enterprise. Proprietary funds use the accrual basis of accounting.

The Clean Water Fund Balance Sheets, Statements of Revenues, Expenses and Changes in Fund Net Assets, and Statements of Cash Flows provide information about the activities of the Fund as a whole and present an overall view of the Fund's finances.

The Balance Sheets include all of the assets and liabilities of the Fund.

The Statements of Revenues, Expenses and Changes in Fund Net Assets divide the activities of the Fund into two categories:

1. Operating Activities, including the Waste Water Loan Program; and
2. Nonoperating Activities, including investment of funds and the Revenue Bond Program.

For the Waste Water Loan Program activities, the statements indicate the amount of loans financed during the past year and the amount of capitalization grants remaining for future use. The statements indicate the amount of interest income generated by the investment of funds and describe the structure of the investments. For the Revenue Bond Program activities, these statements indicate the amount of bonds retired during the year and the remaining amount of bonds to be repaid in the future. Fund financial statements also provide information about activities of the Fund as a recipient of federal capitalization grants. The Clean Water Fund issues revenue bonds and uses the proceeds to provide financing for Clean Water and Drinking Water projects. Where necessary, due to the issuance of bonds and investment activities for both the Clean Water Fund and Drinking Water Fund, interest income and expenses may be allocated between the Clean Water Fund and the Drinking Water Fund.

Net Assets

Net Assets of the Clean Water Fund are categorized as follows:

Restricted – includes net assets that have been restricted in use in accordance with the terms of an award, agreement or by state law.

Unrestricted – includes all net assets not restricted and available for any program purpose.

The Clean Water Fund has issued bonds under three bond resolutions since 1991. The issuance of bonds under the third general bond resolution resulted in the creation of three additional fund accounts within the Clean Water Fund accounts. Two of these accounts, the Senior Sinking Fund and the Support Fund, are restricted accounts and the General Revenue Revolving Fund account is unrestricted. All three accounts are held by the Trustee.

Operating Activities

The Wastewater Loan Program

Loans are made to municipalities for project funding and consist of construction loans or interim funding obligations (IFOs) which accrue interest during construction and long-term permanent financing obligations (PLOs) which are signed after projects are completed. The PLOs have 20 year repayment terms and can be prepaid at any time. There are several state grants available to participants in this program.

Construction loans in progress totaled \$101,692,094, an increase of \$2,368,084 from 2004. Payments to municipalities for ongoing projects totaled \$39,684,920. Completed projects which were permanently financed totaled \$38,007,307. There are no delinquent loans in the Wastewater loan program. Further details about the loans can be found in the notes to the financial statements.

Loan repayment collection services are provided by the Trustee, US Bank. Repayments on loans made by the DEP since 1987 are paid to the Clean Water Fund account held at US Bank. These funds provide security for the Bonds and any new Bonds issued thereafter.

Non-Operating Activities

Investment of Funds

The federal capitalization grants and state matching funds are used to provide leveraged financing for eligible projects in the state. Federal capitalization grants are held by the Trustee in the form of either cash or permitted investments. State contributions are held by the Trustee in the form of cash, permitted investments or State general obligation bonds.

The State currently invests a significant portion of the funds and accounts created under the general bond resolutions in investment agreements with financial institutions. The investment agreements are with, or guaranteed by, institutions with ratings at least equal to the rating on the Bonds given by Standard & Poor's and Moody's Investors Service. Certain monies currently held in the debt service reserve funds are invested pursuant to investment agreements, collateralized with securities issued or guaranteed by the U.S. Government or agencies or instrumentalities thereof whose market value is at least 100% of the funds invested.

The Bond Program

The Connecticut Clean Water Fund has issued long-term debt obligations backed by the pledge of specific assets including loans, reserve funds and other program assets. There are three bond resolutions: the 1990 General Bond Resolution, the 1996 Subordinate Bond Resolution and the 2002 General Revenue Bond Resolution. Long-term debt obligations of the Fund are special obligations of the State which are payable only from the revenues or monies available in the Fund as provided in the Resolutions and the State Act. The proceeds of these bonds were also used to fund loans to Drinking Water Fund borrowers. Further information about outstanding bonds can be found in the notes to the financial statements. No bonds were issued in fiscal year 2005.

The program's advisors are:

Bond Counsel - Nixon Peabody, LLP and Hardwick Law Firm, LLC

Financial Advisors - Lamont Financial Services Corporation and P.G. Corbin & Co., Inc.

General Counsel - Attorney General of the State of Connecticut

Auditor - Seward & Monde CPAs

Trustee - US Bank

Loan Repayment Collection Services - US Bank

SELECTED FINANCIAL INFORMATION

	<u>2005</u>	<u>2004</u>	<u>Increase (Decrease)</u>
Change in Fund Net Assets	\$ 25,088,711	\$ 22,202,398	\$ 2,886,313
Operating Revenues	\$ 12,242,727	\$ 12,267,635	\$ (24,908)
Federal Capitalization Grants	\$ 15,148,470	\$ 1,990,881	\$ 13,157,589
Interest on Investments	\$ 18,263,484	\$ 18,828,893	\$ (565,409)
Operating Expenses	\$ 755,402	\$ 603,177	\$ 152,225
Interest Expense	\$ 26,984,680	\$ 24,154,535	\$ 2,830,145

ECONOMIC CONDITIONS AND OUTLOOK

During fiscal year 2005, the State's economic and financial situation improved over the prior year; employment remained stable or improved and the overall State Budget showed a surplus at the end of the fiscal year, part of which was deposited in the State's Budget Reserve Fund. While the news has generally been good for Connecticut's economy, there were fluctuations in economic conditions during the year including increasing short term interest rates and higher fuel costs. While employment improved, significant job losses in some sectors continued.

State and federal budget constraints have led to reduced authorizations for the program which could lead to a slow down in the initiation of water quality and pollution control projects. DEP and the Treasurer's Office will continue to monitor planning activities and will assist municipalities in determining the most cost effective and efficient way to meet their water quality needs. DEP is continuing to be proactive in identifying needs, setting priorities and working with municipalities to plan compliance with federal water quality laws.

REQUIRED SUPPLEMENTARY INFORMATION

The Clean Water Fund does not separately report required supplementary information that contains budgetary comparison schedules, schedules presenting infrastructure assets or supplementary pension fund information because this information is recorded by the State of Connecticut. The State is in compliance with GASB Statement 34.

The Notes to the Financial Statements provide additional information that further explains and supports the information in the financial statements. The Notes provide additional information that is essential to a full understanding of the data provided in the Clean Water Fund's financial statements.

CONTACTS

This financial report is designed to provide a general overview of the Clean Water Fund's finances. Questions about this report or requests for additional information should be addressed to:

Clean Water Fund Financial Administrator
Connecticut State Treasurer's Office
55 Elm Street
Hartford, CT 06106-1773
Telephone (860) 702-3134
www.state.ct.us/ott

Questions about the Clean Water Fund and water quality in Connecticut should be addressed to:

Connecticut Department of Environmental Protection
450 Capitol Avenue
Hartford, CT 06106
Telephone (860) 424-3704
www.state.ct.us/dep

**STATE OF CONNECTICUT CLEAN WATER FUND -
WATER POLLUTION CONTROL AUTHORITY FEDERAL
REVOLVING LOAN ACCOUNT (STATE REVOLVING FUND)
BALANCE SHEETS
June 30, 2005 and 2004**

	2005	2004
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 4,359,916	\$ 2,966,407
Interest receivable - investments	3,533,190	3,956,433
Interest receivable - loans	3,272,540	2,749,080
Grants receivable	420,596	408,681
Other assets	38,876	-
Loans receivable	141,501,199	136,925,799
Total current assets	<u>153,126,317</u>	<u>147,006,400</u>
Noncurrent assets:		
Loans receivable	474,512,662	479,119,686
Revolving fund	122,295,821	124,406,397
Deferred losses on early retirement of bonds	34,855,103	38,674,085
Restricted assets:		
Loan fund	-	4,086,012
Debt service reserve fund	182,560,943	196,067,745
Debt service fund	81,022,610	74,581,935
Senior sinking fund	17,427,473	17,190,022
Support fund	14,777,146	15,389,109
Total restricted assets	<u>295,788,172</u>	<u>307,314,823</u>
Total noncurrent assets	<u>927,451,758</u>	<u>949,514,991</u>
Total assets	<u>\$ 1,080,578,075</u>	<u>\$ 1,096,521,391</u>
LIABILITIES		
Current liabilities:		
Interest payable on revenue bonds	\$ 5,854,399	\$ 6,431,871
Revenue bonds payable	23,835,696	22,563,949
Refunding bonds payable	10,550,415	15,643,221
Arbitrage liability	2,126,690	2,588,861
Total current liabilities	<u>42,367,200</u>	<u>47,227,902</u>
Noncurrent liabilities:		
Premiums on revenue and refunding bonds	19,585,462	21,370,676
Revenue bonds payable	170,105,205	193,940,901
Refunding bonds payable	317,477,114	328,027,529
Total noncurrent liabilities	<u>507,167,781</u>	<u>543,339,106</u>
Total liabilities	<u>549,534,981</u>	<u>590,567,008</u>
FUND NET ASSETS		
Unrestricted	52,229,926	56,899,724
Restricted for loans	478,813,168	449,054,659
Total fund net assets	<u>531,043,094</u>	<u>505,954,383</u>
Total liabilities and fund net assets	<u>\$ 1,080,578,075</u>	<u>\$ 1,096,521,391</u>

See notes to financial statements.

**STATE OF CONNECTICUT CLEAN WATER FUND -
WATER POLLUTION CONTROL AUTHORITY FEDERAL
REVOLVING LOAN ACCOUNT (STATE REVOLVING FUND)
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS
For the years ended June 30, 2005 and 2004**

	2005	2004
OPERATING REVENUES		
Interest on loans	\$ 12,242,727	\$ 12,267,635
OPERATING EXPENSES		
Salaries	430,580	412,256
Employee benefits	228,208	189,701
Other	96,614	1,220
Total operating expenses	755,402	603,177
Operating income	11,487,325	11,664,458
NONOPERATING REVENUES (EXPENSES)		
Interest on investments	18,263,484	18,828,893
Amortization of bond premium	1,785,214	4,755,595
Interest expense	(26,984,680)	(24,154,535)
Arbitrage	-	(506,036)
Total nonoperating revenues (expenses)	(6,935,982)	(1,076,083)
Income before federal capitalization grants and transfers	4,551,343	10,588,375
FEDERAL CAPITALIZATION GRANTS		
Project funds	14,486,088	1,387,712
Administrative set-asides	662,382	603,169
Total federal capitalization grants	15,148,470	1,990,881
OPERATING TRANSFERS	5,388,898	9,623,142
Change in fund net assets	25,088,711	22,202,398
FUND NET ASSETS, beginning	505,954,383	483,751,985
FUND NET ASSETS, ending	\$ 531,043,094	\$ 505,954,383

See notes to financial statements.

**STATE OF CONNECTICUT CLEAN WATER FUND -
WATER POLLUTION CONTROL AUTHORITY FEDERAL
REVOLVING LOAN ACCOUNT (STATE REVOLVING FUND)
STATEMENTS OF CASH FLOWS
For the years ended June 30, 2005 and 2004**

	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES		
Interest received on loans	\$ 11,028,795	\$ 11,090,724
Loan originations	(39,684,920)	(48,663,253)
Principal paid on loans receivable	40,407,016	39,187,052
Payments to employees	(658,788)	(601,957)
Other payments	(96,614)	(1,220)
Net cash provided by operating activities	<u>10,995,489</u>	<u>1,011,346</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Federal capitalization grants	<u>15,136,555</u>	<u>1,713,604</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Repayment of revenue bonds payable	(22,563,949)	(28,290,603)
Repayment of refunding bonds payable	(15,643,221)	(8,431,911)
Proceeds from revenue bonds payable	-	85,021,200
Proceeds from refunding bonds payable	-	229,587,661
Premium received on revenue and refunding bonds	-	20,153,120
Payment to refunded revenue bond escrow agent	-	(291,594,387)
Interest paid on revenue and refunding bonds	(23,743,170)	(22,716,862)
Operating transfers	5,388,898	9,623,142
Payments on arbitrage liability	(462,171)	-
Net cash used by noncapital financing activities	<u>(57,023,613)</u>	<u>(6,648,640)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received on investments	18,647,851	19,129,844
(Increase) decrease in revolving fund	2,110,576	(124,406,397)
Decrease in restricted assets	<u>11,526,651</u>	<u>111,722,873</u>
Net cash provided by investing activities	<u>32,285,078</u>	<u>6,446,320</u>
Net increase in cash and cash equivalents	1,393,509	2,522,630
CASH AND CASH EQUIVALENTS, beginning	<u>2,966,407</u>	<u>443,777</u>
CASH AND CASH EQUIVALENTS, ending	<u><u>\$ 4,359,916</u></u>	<u><u>\$ 2,966,407</u></u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating income	\$ 11,487,325	\$ 11,664,458
Adjustments to reconcile operating income to net cash provided by operating activities:		
Changes in assets and liabilities:		
Increase in interest receivable - loans	(523,460)	(911,267)
(Increase) decrease in loans receivable	<u>31,624</u>	<u>(9,741,845)</u>
Net cash provided by operating activities	<u><u>\$ 10,995,489</u></u>	<u><u>\$ 1,011,346</u></u>

STATE of CONNECTICUT CLEAN WATER FUND - WATER POLLUTION CONTROL
AUTHORITY FEDERAL REVOLVING LOAN ACCOUNT (STATE REVOLVING FUND)
NOTES to FINANCIAL STATEMENTS
June 30, 2005 and 2004

1 - NATURE OF ORGANIZATION

The State of Connecticut Clean Water Fund - Water Pollution Control Authority Federal Revolving Loan Account (State Revolving Fund) (SRF) (an enterprise fund of the State of Connecticut), established pursuant to Connecticut General Statutes Section 22a-475 to 22a-483, provides financial assistance to the municipalities of Connecticut for the planning, design and construction of water quality projects. The SRF is funded through revenue bonds, State contributions, and federal grants as established under Title VI of the Water Quality Act of 1987 (Act), which requires the State of Connecticut (State) to match federal funds to the extent of 20% of federal funds received.

2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the SRF conform to U.S. generally accepted accounting principles as applicable to government enterprises. The following is a summary of the SRF's significant accounting policies:

Basis of Accounting

The financial statements are prepared using the accrual basis of accounting and the flow of economic resources as specified by the Governmental Accounting Standards Board's (GASB) requirements for an enterprise fund.

Under GASB Statement No. 20, *Accounting and Reporting for Proprietary Funds and other Governmental Entities that Use Proprietary Fund Accounting*, the SRF has elected to apply all Financial Accounting Standards Board Statements and Interpretations issued on or before November 30, 1989, except those that conflict with or contradict GASB pronouncements.

Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Operating and Nonoperating Revenues and Expenses

The SRF's principal operation consists of making low interest loans to municipalities in Connecticut. Operating revenue consists of interest earned on those loans. Operating expenses consist of personnel and other expenses incurred in the initial approval, disbursement and ongoing servicing of those loans through maturity.

Nonoperating revenues include interest earned on investments and nonoperating expenses include interest expense on revenue and refunding bonds.

Revenue Recognition

Federal capitalization grants are reported as nonoperating revenue and are recognized as federal funds are loaned to municipalities and as the SRF expenditures for administration are made.

Cash and Cash Equivalents

For purposes of the statements of cash flows, the SRF considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. However, the SRF's policy is to exclude restricted assets from cash equivalents for purposes of the statements of cash flows due to the limitations imposed on their use by the Clean Water Fund Revenue Bond Program General Bond Resolutions, adopted by the State Bond Commission on December 7, 1990, as amended and supplemented and on December 17, 2002 (collectively, the "Resolution"). The SRF had cash equivalents of \$219 and \$214 as of June 30, 2005 and 2004, respectively, which consisted of amounts invested in the State Treasurer's Short Term Investment Fund (STIF), an investment pool. The pool is managed by the State Treasurer's Office, and the fair market value of the SRF's position in the pool is the same as the value of the pool shares. Cash equivalents included in restricted assets are presented in Note 6.

Investments

The SRF's policy is to present all investments at fair value except for money market investments and investment contracts, which the SRF has elected to report at amortized cost. The fair value of investments traded on public markets is determined using quoted market prices. The fair value of state general obligation bonds, which are not traded on a public market, is estimated using matrix pricing. The cost of the state general obligation bonds approximates their estimated fair value.

There were no material investment gains or losses for the years ended June 30, 2005 and 2004.

Loans, Allowance for Loan Losses and Credit Risk

The SRF makes loans to municipalities in the State of Connecticut for planning, design and construction of water quality projects. Interest on the loans is calculated at two percent of the outstanding balance and recognized as it is earned. The loans are secured by the full faith and credit or revenue pledges of the municipalities, or both. No allowance for loan losses is considered necessary based on management's evaluation of the collectibility of the loans. The evaluation takes into consideration such factors as changes in the size of the municipal loans, overall quality, review of specific problem loans, and current economic conditions and trends that may affect the borrowers' ability to pay.

Restricted Assets

Restricted assets consist of investments, which are segregated into funds and accounts in accordance with the Resolution as previously described plus amounts determined to be prudent by management. The Resolutions restricts investments to: a) the State Treasurer's Short-Term Investment Fund, b) Tax Exempt Proceeds Fund of the State, c) interest bearing time deposits held by the trustee, a member bank of the Federal Reserve System, or a bank which is insured by the Federal Deposit Insurance Corporation and d) Investment Obligations as defined in the Resolution.

Bond Premiums/Deferred Loss

The premiums on the revenue and refunding bonds are being amortized over the term of the bonds on a straight-line basis, which yields results equivalent to the interest method. The deferred losses on early retirement of bonds (Note 8) are being amortized using the outstanding bond method, which yields results equivalent to the interest method.

Revenue Bonds

The following funds and accounts have been established in accordance with the Resolution adopted on December 7, 1990:

<u>Fund / Account</u>	<u>Description and Use</u>
Revenue Fund	Receives all pledged receipts including loan repayments from the municipalities. Out-flows include amounts transferred to the interest and principal accounts of the debt service fund for payment of current debt service.
a. Pledged Receipts Account	
b. Earnings Account	Receives all earnings on funds and investments in all funds and accounts. Out-flows include amounts transferred to the interest and principal accounts of the debt service fund for payment of current debt service.
Loan Fund	Received proceeds from the sale of revenue bonds as specified and determined by the Resolution. Funds expended for purposes of the State Revolving Fund program, including the financing of loans to municipalities.
Debt Service Reserve Fund	Required to be funded in an amount equal to 50% of all outstanding bonds. The reserve is funded by federal capitalization grant payments drawn under the federal letter of credit and state general obligation bonds. Investment income is transferred to the revenue fund for debt service payments. Used for payment of principal and interest in the event of deficiencies in the revenue accounts.
Debt Service Fund	Receives amounts from the revenue fund accounts sufficient to pay the interest portion due on each interest payment date. Pays interest on outstanding bonds.
a. Interest Account	
b. Principal Account	Receives amounts from the revenue fund accounts sufficient to pay the principal or current sinking fund installments. Pays principal on outstanding bonds.
c. Redemption Account	Receives amounts from the interest and principal accounts for the redemption of bonds. Used for redemption of bonds.
d. Capitalized Interest Account	Receives any capitalized interest received by the trustee. Amounts in the account are transferred for payment of capitalized interest on outstanding bonds.
Interest Subsidy Fund	Established outside of the state revolving fund, principal and investment income is transferred to the revenue fund, then to the debt service fund for payment of debt service. Provides payment of principal and interest in the event of a deficiency in the debt service reserve fund.
Administrative Fund: Cost of Issuance Account	Established outside the SRF, receives a portion of the revenue bond proceeds. Investment income is transferred to the revenue fund for debt service payments. Used to pay issuance cost on revenue bonds.
Rebate Fund	Receives any earnings required to be rebated to the United States pursuant to the Tax Regulatory Agreement. Used for IRS obligations as required.

The following funds and accounts have been established in accordance with the Resolution adopted December 17, 2002:

Fund / Account	Description and Use
Revolving Fund	The Revolving Fund from which the Bonds are repaid consists of amounts in the water pollution control federal revolving loan account and drinking water federal revolving loan account. The State will maintain the Revolving Fund in accordance with the Federal Act.
Loan Fund	Receives proceeds from the sale of revenue bonds as specified and determined by the Resolution. Funds expensed for purposes of financing loans to borrowers under the State Revolving Fund program and if other monies are not available, payment of principal and interest on bonds.
Debt Service Fund	Receives amounts from the Revolving Fund, Support Fund and Loan Fund sufficient to pay the debt service on the bonds. Pays principal and interest on outstanding bonds.
Support Fund	The Support Fund, and accounts therein, shall be funded in the amounts and in the manner set forth in a Supplemental Resolution. Monies in the Support Fund shall be transferred to the Debt Service Fund to pay the interest, principal and Sinking Fund Installments and Redemption Price due on Bonds, in accordance with the schedule set forth in the applicable Supplemental Resolution.
Administrative Fund: Cost of Issuance Account	Established outside the SRF, receives a portion of the revenue bonds proceeds. Investment income is transferred to the revenue fund for debt service payments. Used to pay issuance cost on revenue bonds.
Rebate Fund	Receives any earnings required to be rebated to the United States pursuant to the Tax Regulatory Agreement. Used for IRS obligations as required.

Fund Net Assets - Restricted for Loans

The fund net assets restricted for loans represents amounts accumulated from federal drawdowns, less administrative expenses not exceeding 4% of the federal grant, transfers from the State representing the 20% match on federal funds and interest earned on municipal loans.

3 - CASH DEPOSITS AND INVESTMENTS

Cash Deposits

Cash deposits are classified in categories of custodial credit risk. This is the risk that, in the event of the failure of a depository financial institution, the SRF will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. Cash deposits of the SRF include funds held by the Connecticut State Comptroller and the Connecticut Short Term Investment Fund (STIF). As of June 30, 2005 funds held by the State Comptroller were \$4,359,697. These funds are pooled with other State of Connecticut accounts, and custodial credit risk cannot be determined at the SRF level. As of June 30, 2005 funds held by STIF were \$76,074,989, of which \$76,074,770 is included in the revolving fund on the Balance Sheet. STIF is a money market investment pool, rated AAAM by Standard and Poor's, in which the State, municipal entities, and political subdivisions of the State are eligible to invest. The State is authorized to invest STIF funds in U.S. government and agency obligations, certificates of deposit, commercial paper, corporate bonds, savings accounts, bankers' acceptances, repurchase agreements, asset-backed securities, and student loans.

Investments

As of June 30, 2005, the SRF had the following investments and maturities:

Investment Type	Fair Value	Investment Maturities (in years)				Rating
		Less than 1	1 - 5	6 - 10	More than 10	
Federated Treasury Repurchase Agreements	\$ 60,171,849	\$ 60,171,849	\$ -	\$ -	\$ -	AAA
Guaranteed Investment Contracts	155,837,864	-	19,046,628	1,459,380	135,331,856	AAA
Guaranteed Investment Contracts	77,586,329	-	-	37,323,448	40,262,881	AA-
Connecticut General Obligation Bonds	48,413,181	-	-	15,451,859	32,961,322	AA
	<u>\$ 342,009,223</u>	<u>\$ 60,171,849</u>	<u>\$ 19,046,628</u>	<u>\$ 54,234,687</u>	<u>\$ 208,556,059</u>	

Interest Rate Risk

The maturity or redemption dates of investment shall coincide as nearly as practicable with the times at which funds will be required for purposes as established in the General Bond Resolutions.

4 - LOANS RECEIVABLE

The SRF loans funds to qualified municipalities at an annual interest rate of two percent, secured by the full faith and credit or revenue pledges of the municipalities, or both. Principal and interest payments on loans are payable over a 20 year period in equal monthly installments commencing one month after the scheduled completion date, or in a single annual installment representing the first year's principal and interest not later than one year after the scheduled completion date and thereafter in monthly or annual installments.

Loans receivable by type are as follows as of June 30:

	<u>2005</u>	<u>2004</u>
Construction in process	\$ 101,692,094	\$ 99,324,010
Completed projects	<u>514,321,767</u>	<u>516,721,475</u>
	<u>\$ 616,013,861</u>	<u>\$ 616,045,485</u>

Aggregate maturities of loans receivable in subsequent years for completed projects are as follows:

<u>Year ending June 30</u>	
2005	\$ 39,809,105
2006	40,489,296
2007	40,986,359
2008	41,493,451
2009	41,874,369
Thereafter	<u>309,669,187</u>
	<u>\$ 514,321,767</u>

5 - FEDERAL LETTER OF CREDIT

The following represents a summary of the funds available under the U.S. Environmental Protection Agency's letter of credit as of June 30:

	<u>2005</u>	<u>2004</u>
Awarded	\$ 327,222,396	\$ 294,514,024
Requested	<u>307,492,622</u>	<u>292,356,068</u>
Available federal letter of credit	<u>\$ 19,729,774</u>	<u>\$ 2,157,956</u>

6 - RESTRICTED ASSETS

Restricted assets as of June 30 are comprised of the following:

	<u>2005</u>	<u>2004</u>
Cash equivalents:		
Money market funds	\$ -	\$ 4,086,012
Investments:		
Federated Treasury Repurchase Agreements	59,004,608	46,766,242
Guaranteed Investment contracts	233,424,193	252,878,822
Connecticut General Obligation Bonds	<u>3,359,371</u>	<u>3,583,747</u>
	<u>\$ 295,788,172</u>	<u>\$ 307,314,823</u>

7 - RELATED PARTY TRANSACTIONS

The SRF is one fund of many within the State of Connecticut financial reporting structure and as a result, certain transactions including operating transfers, loans receivable and allocation of expenses among funds are under the direction of the State.

Investments

The SRF has invested in the State Treasurer's Short Term Investment Fund. The SRF also holds State General Obligation Bonds as presented in Note 6.

Allocation of Expenses

Fringe benefit costs which are incurred at the State level are applied as a percentage of salaries to all State governmental units, including the SRF. For the years ended June 30, 2005 and 2004, the basic rates were 53.00% and 45.82%, respectively, of the SRF wages and the amounts charged aggregated \$228,208 and \$189,701, respectively.

8 - BONDS PAYABLE

A summary of changes in bonds payable during the year ended June 30, 2005 is as follows:

	Balance June 30, 2004	Principal Paydown	Balance June 30, 2005
Revenue bonds payable	\$ 216,504,850	\$ 22,563,949	\$ 193,940,901
Subordinate refunding bonds payable	115,985,000	11,545,000	104,440,000
Refunding bonds payable	227,685,750	4,098,221	223,587,529
	<u>\$ 560,175,600</u>	<u>\$ 38,207,170</u>	<u>\$ 521,968,430</u>

A summary of changes in bonds payable during the year ended June 30, 2004 is as follows:

	Balance June 30, 2003	Additional Borrowings	Principal Paydown	Advanced Refunding	Balance June 30, 2004
Revenue bonds payable	\$ 414,745,253	\$ 85,021,200	\$ 28,290,603	\$ 254,971,000	\$ 216,504,850
Subordinate refunding bonds payable	122,515,000	-	6,530,000	-	115,985,000
Refunding bonds payable	-	229,587,661	1,901,911	-	227,685,750
	<u>\$ 537,260,253</u>	<u>\$ 314,608,861</u>	<u>\$ 36,722,514</u>	<u>\$ 254,971,000</u>	<u>\$ 560,175,600</u>

Revenue Bonds

The proceeds of the SRF's bonds are to be used to provide funds to make loans to Connecticut municipalities, for use in connection with the financing or refinancing of wastewater and drinking water treatment projects.

The State of Connecticut issued Clean Water Fund, Revenue Bonds 1999, 1997, 1996, 1994, 1993, 1992 and 1991 series, dated April 15, 1999, September 1, 1997, March 1, 1996, June 1, 1994, January 1, 1993, 1992 and 1991, respectively. The bonds are payable solely from funds pledged pursuant to the General Bond Resolution adopted December 7, 1990.

The State of Connecticut issued Clean Water Fund Revenue Bonds 2001 series dated May 24, 2001. In accordance with the State Clean Water Fund Revenue Bonds, 2001 Series Plan of Finance, the State allocated the proceeds of 2001 series between the SRF and the State of Connecticut Drinking Water Fund - State Revolving Fund ("Drinking Water Fund") (collectively, "The Obligated Group") with \$70,385,253 allocated to the SRF and \$29,614,747 allocated to the Drinking Water Fund. The Drinking Water Fund (an enterprise fund of the State of Connecticut) was also established pursuant to Connecticut General Statutes Section 22a-475 to 22a-483 and provides assistance to

municipalities of Connecticut to finance the costs of infrastructure needed to achieve or maintain compliance with the Safe Drinking Water Fund Act. Debt service on the 2001 series bonds is to be paid from pledged receipts, earnings on investments held in the debt service reserve funds and maturing principal and interest on investments held in the interest subsidy funds. "Pledged receipts" means payments of principal and interest on municipal obligations, including both timely and delinquent payments with late charges, if any, and includes any fees and charges, fines and penalties collected or held by the State.

Pledged receipts include the repayments of loans made by the Obligated Group, including all loans previously funded as well as future loans. Although amounts attributable to the Obligated Group will be tracked separately for federal reporting purposes, all pledged receipts will secure all bonds of the Clean Water Fund Revenue Bond Program. The Act and the General Bond Resolution adopted December 7, 1990 permit the pledging of assets of both the SRF and the Drinking Water Fund SRF to secure all bonds.

The State of Connecticut issued Clean Water Fund Revenue Bonds 2003 series dated July 10, 2003. In accordance with the State Clean Water Fund Revenue Bonds, 2003 Series Plan of Finance, the State allocated the proceeds of 2003 series between the SRF and the Drinking Water Fund with \$85,021,200 allocated to the SRF and \$33,063,800 allocated to the Drinking Water Fund. Debt service on the 2003 series bonds is to be paid from any available monies in the SRF and the Drinking Water Fund. The State has pledged amounts in the loan fund, the support fund and the debt service fund pursuant to the General Bond Resolution adopted December 17, 2002.

Revenue bonds payable consist of the following as of June 30:

	<u>2005</u>	<u>2004</u>
Serial bonds, with interest rates from 2.00% to 6.375%, maturing from 2006 through 2026	\$ 181,130,901	\$ 203,694,850
Term bonds, with interest rates ranging from 5.125% to 6%, maturing from 2012 through 2020	<u>12,810,000</u>	<u>12,810,000</u>
	<u>\$ 193,940,901</u>	<u>\$ 216,504,850</u>

Refunding Bonds - 1996 Series

On March 15, 1996 the State issued \$48,445,000 of Clean Water Fund Refunding Bonds, 1996 Series (1996 Refunding Bonds) with interest rates of 3.45% to 5.6% to advance refund Clean Water Fund 1991 Series Revenue Bonds (Refunded Bonds) with a principal balance of \$43,125,000 and interest rates of 6.3% to 7%. The Refunded Bonds were to mature at various dates through January 1, 2011 but were called on January 1, 2001.

The net proceeds of the 1996 Refunding Bonds of \$47,478,959 were used to purchase U.S. Government securities and those securities were placed in an irrevocable trust with an escrow agent to provide debt service payments until the Refunded Bonds were called on January 1, 2001. The advance refunding met the requirements of an in-substance debt defeasance and, accordingly, the Refunded Bonds with a principal balance of \$43,125,000 were removed from the SRF's balance sheet.

The difference of \$4,733,836 between the book value of the Refunded Bonds and the amount deposited to the irrevocable trust to fund their debt service represents a loss which has been deferred and is being recognized as an adjustment of interest expense over the life of the 1996 Refunding Bonds using the outstanding bond method. Amortization of the deferred loss for the years ended June 30, 2005 and 2004 totaled \$343,794 and \$390,726, respectively.

Refunding Bonds - 1999 Series

On May 1, 1999 the State, with State Street Bank as Trustee, issued \$78,995,000 of Clean Water Fund Subordinate Revenue Refunding Bonds, 1999 Series (1999 Refunding Bonds) with interest rates of 3.45% to 5.25% to advance refund Clean Water Fund 1991, 1992 and 1994 Series Revenue Bonds (Refunded Bonds) with principal balances totaling \$74,080,000 and interest rates of 5.65% to 6.7%. The Refunded Bonds were to mature at various dates through June 1, 2016 but were called on June 1, 2004.

The net proceeds of the 1999 Refunding Bonds of \$80,413,679 were used to purchase U.S. Government securities and those securities were placed in an irrevocable trust with an escrow agent to provide debt service payments until the Refunded Bonds were called on various dates through June 1, 2004. The advance refunding met the requirements of an in-substance debt defeasance and, accordingly, the Refunded Bonds with a principal balance of \$74,080,000 were removed from the SRF's balance sheet.

The difference of \$6,338,445 between the book value of the Refunded Bonds and the amount deposited to the irrevocable trust to fund their debt service represents a loss which has been deferred and is being recognized as an adjustment of interest expense over the life of the 1999 Refunding Bonds using the outstanding bond method. Amortization of the deferred loss for the years ended June 30, 2005 and 2004 totaled \$492,303 and \$527,488, respectively.

Refunding Bonds – 2003 Series

On July 10, 2003 the State issued \$115,785,000 of Clean Water Fund Refunding Bonds 2003, Series B with interest rates of 2.0% to 5.9% and \$121,375,000 of Clean Water Fund Refunding Bonds, 2003 Series C as auction rate bonds to advance refund Clean Water Fund 1991, 1992, 1994, 1996, 1997, 1999 and 2001 Series Revenue Bonds (Refunded Bonds) with principal balances totaling \$272,805,000 and interest rates of 4.3% to 7.0%. The State allocated \$7,572,339 of the 2003 Series B Refunding Bonds to the Drinking Water Fund. The Refunded Bonds mature at various dates through September 1, 2022.

The net proceeds of the 2003 Series B and C Refunding Bonds of \$291,594,387 were used to purchase U.S. Government securities and those securities were placed in an irrevocable trust with an escrow agent to provide debt service payments until the Refunded Bonds are called on various dates through October 1, 2011. The advance refunding met the requirements of an in-substance debt defeasance and, accordingly, the Refunded Bonds with a principal balance of \$254,971,000 were removed from the SRF's balance sheet. As of June 30, 2005, the outstanding principal balance of the Refunded Bonds was \$184,861,000.

The difference of \$37,699,081 between the book value of the Refunded Bonds and the amount deposited to the irrevocable trust to fund their debt service represents a loss which has been deferred and is being recognized as an adjustment of interest expense over the life of the 2003 Series B and C Refunding Bonds using the outstanding bond method. Amortization of the deferred loss for the years ended June 30, 2005 and 2004 totaled \$2,982,885 and \$2,729,163, respectively.

The interest rate on the 2003 Series C Bonds was hedged with an interest rate swap (see Note 10). At June 30, 2005, debt service requirements of the variable-rate bonds and net swap payments, assuming current interest rates remain the same, for their term were as follows. As rates vary, variable-rate bond interest payments and net swap payments will vary.

Year ending June 30,	Principal	Interest	Interest Rate Swaps, Net	Total
2006	\$ -	\$ 2,901,726	\$ 1,080,944	\$ 3,982,670
2007	-	2,901,726	1,080,944	3,982,670
2008	-	2,905,334	1,082,288	3,987,622
2009	-	2,901,726	1,080,944	3,982,670
2010	-	2,901,726	1,080,944	3,982,670
2011-2015	-	14,634,150	5,451,476	20,085,626
2016-2020	79,025,000	10,188,666	3,795,456	93,009,122
2021-2023	42,350,000	1,122,677	418,217	43,890,894
	<u>\$ 121,375,000</u>	<u>\$ 40,457,731</u>	<u>\$ 15,071,213</u>	<u>\$ 176,903,944</u>

Bond Maturities

Requirements at June 30, 2005 to retire the SRF's revenue and refunding bonds are as follows:

<u>Year ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2006	\$ 34,386,111	\$ 22,804,658
2007	31,545,526	19,594,260
2008	41,749,042	19,456,585
2009	33,768,345	16,760,408
2010	37,437,676	15,709,476
2011-2015	143,735,593	56,916,550
2016-2020	128,790,137	24,099,887
2021-2025	68,363,600	4,788,549
2026	2,192,400	46,040
	<u>\$ 521,968,430</u>	<u>\$ 180,176,413</u>

9 - ARBITRAGE LIABILITY

The Internal Revenue Code provides that interest on certain obligations issued by states, including SRF revenue bonds, are not taxable to the holder provided that bond proceeds are not invested in higher yielding investments, which is referred to as arbitrage. To mitigate arbitrage with respect to the SRF's 1996, 1997, 1999, 2001 and 2003 series revenue bonds, the SRF is required to remit excess investment income to the federal government.

10 – INTEREST RATE SWAPS

The State entered into an interest rate swap in connection with its \$121,375,000 2003 Series C auction rate Clean Water Fund Refunding Bonds to lock-in a synthetic fixed rate of 3.1789%. The swap was enhanced with a structure which included two components in order to better match the swap payments with the underlying auction rates.

The State secured a fixed payment rate of 3.0299% with Swap A in return for receiving a floating payment rate of 1-month London Interbank Offered Rate (LIBOR) multiplied by 67%. Swap A includes an option for the State to terminate the agreement effective October 1, 2013 and semiannually thereafter. The notional amount of the swap mirrors the amortization schedule of the 2003 Series C Bonds.

The floating rates on the 2003 Series C bonds are expected to trade based on the tax-exempt Bond Market Association Municipal Swap index, which has historically averaged around 67% of LIBOR. However, there is a risk that the Bond Market Association (BMA) index could equal more than 67% of LIBOR creating a mismatch between floating receipts from the swap agreement and floating interest payments under the 2003 Series C bonds. This situation generally happens when interest rates are low and is called basis risk. To hedge this risk, the State entered into Swap B.

Swap B pays the State a floating rate equaling the lesser of 33% of LIBOR or (58% of LIBOR plus 0.39%) minus 67% of LIBOR, subject to a 0% minimum. The State makes fixed payments with an interest rate of 0.149%. Swap B matures on October 1, 2013 and contains no termination option. The combined effect of the swaps is that the State receives a higher percentage of LIBOR when LIBOR rates are below 4.33% (to a maximum of 100% of LIBOR) and a lower percentage of LIBOR when rates are higher (to a minimum of 67% of LIBOR). The creation of this structure ("Collar") approximates the relationship between the BMA and the taxable LIBOR index, thereby reducing basis risk.

The total value of Swap A, valued using forward LIBOR rates to estimate future payments and receipts with the 2013 par termination option, is estimated to be \$1,662,051 and \$8,038,784 as of June 30, 2005 and 2004, respectively. Due to the unique nature of the option, this estimate is theoretical and includes assumptions about future interest rate volatility.

Swap B had a negative value of \$700,210 and \$774,699 as of June 30, 2005 and 2004, respectively. Swap B was also valued using forward LIBOR rates to estimate future payments and receipts. This methodology may understate the value of the implied Collar structure somewhat as it does not factor-in the probability that interest rates may continue to stay low enough (or rise and fall again) for the State to continue to receive payments under Swap B. Included in the value are the floor and cap components of the Collar.

At June 30, 2005, the Clean Water Fund was exposed to minimal credit risk related to the swaps. The swap counterparty was rated AA+ by Standard & Poor's and Aaa by Moody's Investors Service as of June 30, 2005.

11 - FUND NET ASSETS

The following represents an analysis of fund net assets for the years ended June 30, 2005 and 2004.

	<u>Unrestricted</u>	<u>Restricted for Loans</u>	<u>Total</u>
Balance at June 30, 2003	\$48,750,849	\$435,001,136	\$483,751,985
Change in fund net assets	<u>8,148,875</u>	<u>14,053,523</u>	<u>22,202,398</u>
Balance at June 30, 2004	56,899,724	449,054,659	505,954,383
Change in fund net assets	<u>(4,669,798)</u>	<u>29,758,509</u>	<u>25,088,711</u>
Balance at June 30, 2005	<u>\$ 52,229,926</u>	<u>\$478,813,168</u>	<u>\$ 531,043,094</u>

12 - OPERATING TRANSFERS

Operating transfers consist of the following for the years ended June 30:

	<u>2005</u>	<u>2004</u>
Interest subsidy transfers	\$ 2,551,856	\$ 2,632,758
Pledged loan repayments	2,189,663	2,203,014
Loan expenditure transfers	-	(2,154)
Operating expenses transfer	662,382	603,169
Operating expenses reimbursement	(325,888)	(656,377)
Drinking Water Fund debt service payment	-	546,596
Transfers related to bond offerings	<u>310,885</u>	<u>4,296,136</u>
	<u>\$ 5,388,898</u>	<u>\$ 9,623,142</u>

13 - LOAN FUNDING COMMITMENTS

The SRF has entered into various loan agreements with municipalities to fund the planning, design and construction of water quality projects. The following represents a summary of loan commitments at June 30:

	<u>2005</u>	<u>2004</u>
Total funds committed to municipalities	\$ 774,125,290	\$ 804,380,796
Loan amount outstanding to municipalities	<u>616,013,861</u>	<u>616,045,485</u>
Loan commitments outstanding	<u><u>\$ 158,111,429</u></u>	<u><u>\$ 188,335,311</u></u>

14 - RISK MANAGEMENT

The State of Connecticut is responsible for risk management of the SRF activities through the use of commercial and self-insurance.

SEWARD AND MONDE

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INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Ms. Denise L. Nappier, Treasurer

Ms. Gina McCarthy, Commissioner,
Department of Environmental Protection,
State of Connecticut

We have audited the financial statements of the State of Connecticut Clean Water Fund - Water Pollution Control Authority Federal Revolving Loan Account (State Revolving Fund) (SRF) (an enterprise fund of the State of Connecticut) as of and for the year ended June 30, 2005, and have issued our report thereon dated August 26, 2005. We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit, we considered the SRF's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the SRF's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the management of the SRF and federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

Seward and Monde

North Haven, Connecticut
August 26, 2005

SEWARD AND MONDE

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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM, ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133, AND ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Ms. Denise L. Nappier, Treasurer

Ms. Gina McCarthy, Commissioner,
Department of Environmental Protection,
State of Connecticut

COMPLIANCE

We have audited the compliance of the State of Connecticut Clean Water Fund - Water Pollution Control Authority Federal Revolving Loan Account (State Revolving Fund) (SRF) (an enterprise fund of the State of Connecticut) with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to its major federal program for the year ended June 30, 2005. The SRF's major federal program is identified in the summary of auditors' results section of the accompanying schedule of federal findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to its major federal program is the responsibility of the SRF's management. Our responsibility is to express an opinion on the SRF's compliance based on our audit.

We conducted our audit of compliance in accordance with U.S. generally accepted accounting standards; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the SRF's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the SRF's compliance with those requirements.

In our opinion, the SRF complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended June 30, 2005.

INTERNAL CONTROL OVER COMPLIANCE

The management of the SRF is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the SRF's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

We have audited the financial statements of the SRF as of and for the year ended June 30, 2005, and have issued our report thereon dated August 26, 2005. Our audit was performed for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

This report is intended solely for the information and use of the management of the SRF and federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

Seward and Monde

North Haven, Connecticut
August 26, 2005

STATE OF CONNECTICUT CLEAN WATER FUND - WATER POLLUTION CONTROL
AUTHORITY FEDERAL REVOLVING LOAN ACCOUNT (STATE REVOLVING FUND)
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the year ended June 30, 2005

<u>Federal Grantor; Program Title</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>
ENVIRONMENTAL PROTECTION AGENCY		
Direct:		
Capitalization Grants for State Revolving Fund	66.458	<u>\$ 15,148,470</u>

See notes to schedule.

STATE of CONNECTICUT CLEAN WATER FUND - WATER POLLUTION CONTROL
AUTHORITY FEDERAL REVOLVING LOAN ACCOUNT (STATE REVOLVING FUND)
NOTES to SCHEDULE of EXPENDITURES of FEDERAL AWARDS
For the year ended June 30, 2005

A - ACCOUNTING BASIS

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the State of Connecticut Clean Water Fund - Water Pollution Control Authority Federal Revolving Loan Account (State Revolving Fund) and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of the financial statements.

Revenues are recognized to the extent of expenditures. Expenditures have been recognized to the extent that administrative costs have been incurred by the SRF and charged to the grant and federal funds have been loaned to municipalities during the year.

B - MUNICIPAL LOAN BALANCES

The balance of outstanding loans to municipalities totaled \$616,013,861 as of June 30, 2005.

STATE of CONNECTICUT CLEAN WATER FUND - WATER POLLUTION CONTROL
AUTHORITY FEDERAL REVOLVING LOAN ACCOUNT (STATE REVOLVING FUND)
SCHEDULE of FEDERAL FINDINGS and QUESTIONED COSTS
For the year ended June 30, 2005

SECTION I - SUMMARY OF AUDITORS' RESULTS

Financial Statements

Type of auditors' report issued: Unqualified

Internal control over financial reporting:

Material weakness(es) identified? ☐ Yes ☒ No

Reportable condition(s) identified not considered to be material weaknesses? ☐ Yes ☒ None reported

Noncompliance material to financial statements noted? ☐ Yes ☒ No

Federal Awards

Internal control over major programs:

Material weakness(es) identified? ☐ Yes ☒ No

Reportable condition(s) identified not considered to be material weaknesses? ☐ Yes ☒ None reported

Type of auditors' report issued on compliance for major program: Unqualified

Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)? ☐ Yes ☒ No

Identification of Major Programs:

<u>CFDA Number</u>	<u>Name of Federal Program</u>
66.458	Capitalization Grants for State Revolving Fund

Auditee qualified as low risk auditee? ☒ Yes ☐ No

Dollar threshold used to distinguish between type A and type B programs \$454,454

SECTION II - FINANCIAL STATEMENT FINDINGS

No findings are reported.

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

No findings or questioned costs are reported.